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IN THE

Supreme Court of the United States

October Term 1971

Docket No. 71-1197

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Petitioners,

against

J. WALTER THOMPSON COMPANY,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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The petition seeks grant of certiorari on two grounds, namely, that the Court of Appeals decided an important state question in conflict with applicable state law, and that it has decided an important question of federal law which has not been, but should be, settled by this Court (Rule 19, 1(b)).

Summary of Reasons for Denying Certiorari

The petition, which does not state "special and important" reasons for this Court to grant the writ, should be denied for the following reasons:

(1) This Court will "not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts." *Huddleston* v. *Dwyer,* 322 U.S. 232, 237 (1944); *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 707-8 (1949).

(2) The Court of Appeals decided the issue in precise accord with state law, as reflected in *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957).

(3) The decision below,—which is merely a holding that the disclosure provisions of SEC Rule 10b-5 have no application to sale of stock under a pre-existing option contract, because, regardless of what may or may not be disclosed, the seller is already contractually obligated to sell, —does not involve an important question of federal law.

(4) The issue does not involve any principle of public or far-reaching importance, and it has no significance beyond this particular case.

(5) Petitioners' position is based on a special fact situation and the construction of particular option provisions in Respondent's certificate of incorporation, and certiorari is not granted to review evidence, discuss specific facts, or review the construction of particular contracts or written instruments (*United States* v. *Johnston,* 268 U.S. 220, 227 (1925)).

The Opinions Below

The Court of Appeals' *per curiam* opinion relied on "the District Court's clear, comprehensive and detailed statement of the facts" (A. 3), and affirmed upon its "well reasoned opinion" (A. 5). Accordingly, review of the Court of Appeals' opinion necessarily involves review of the District Court's opinion. This was belatedly recognized by Petitioners, who did not include the District Court's opinion in their original petition, necessitating a Supplemental Appendix (A. 10-23).

Questions Presented

(1) Does a provision in the certificate of incorporation of a 100% employee-owned New York corporation, which requires a retired shareholder-employee to afford the corporation a first 90-day option to buy the stock, at a formula price, in order to maintain employee-ownership, become invalid under New York law because, months after the option was exercised and the stock sold, the corporation ceased to be 100% employee-owned and became 27% publicly-owned and 73% employee-owned?

(2) Can a former stockholder of a 100% employee-owned New York corporation, who sold his stock to the corporation on its exercise of an option, rescind the sale under SEC Rule 10b-5, on the ground that when the sale was made, the corporation did not disclose to the seller that it was planning and taking steps to offer shares to the public, and thereby become 73% employee-owned, instead of 100% employee-owned?

Statement of the Case

Petitioner Ryan, a former employee of Respondent J. Walter Thompson Company ("Thompson"), "the largest advertising agency in the world" (A. 11) and previously 100% employee-owned, bought Thompson stock from time to time at a formula price of net asset value, exclusive of good will. All Thompson stock was sold to employees subject to a 90-day first option in Thompson to repurchase in certain events, which included the employee's retirement, termination of employment before retirement or proposed sale to a third party. The option price was based on the same formula as the sales price to the employee, namely, net asset value, exclusive of good will.

Ryan, aware of the option and its full implications, testified that the option was "gospel," and that he knew of his obligation to resell on retirement "just like I knew my name was Ryan and I was working for J. Walter Thompson" (R. 39, pp. 41, 84-5). The option, as the District Court stated, was "a matter of contract between Ryan and Thompson" (A. 20).

Ryan paid $83,686 for his stock and, because of increase in net asset value, received $276,200 from Thompson on the repurchase, with a $192,514 profit, apart from dividends, —a price he described as "gratifying" (A. 15).

Because Thompson's substantial good will was not reflected in the price of net asset value, at which stock was sold to employees, and because the stock was subject to repurchase at net asset value, Ryan always bought well

below the stock's value, if good will were included. He now seeks to rescind his sale to Thompson, because, despite his substantial profit, the stock would have been worth more than the option price, if the option could be deemed invalid and the stock could be valued with inclusion of good will.

Ryan sold his stock to Thompson on January 14, 1969. On June 4, 1969, Thompson made a public offering of 27% of its stock, which resulted in its becoming 73%, rather than 100%, employee-owned.

In January 1969, when Ryan sold his stock, Thompson was seriously considering the public offering, but its decision was awaiting clearance with principal clients to ascertain whether any would object to public ownership. Thompson sought to maintain confidentiality, so that its clients would not first hear of the possible public offering from outside sources. After clearance with all Thompson's principal clients, which "took place in January, February and March 1969" (A. 15), the proposed offering was publicly announced on March 28, 1969 (A. 15), over two months after Ryan had sold his stock. The offering was made on June 4, 1969, over four months after Ryan's sale.

However, until the actual public offering on June 4, 1969, there was no certainty it would be made. This was recognized by Ryan's counsel, whose affidavit in support of summary judgment stated that Ryan made no claim that before he had sold his stock under the option, "Thompson made a final and irrevocable commitment to 'go public'" (App. below, p. 85a). The District Court held that Thompson had "no assurance that there would be a successful

public offering until June 4, 1969 when the Underwriting Agreement was executed" (A. 18-19).

It is Ryan's position that had he known Thompson was planning a public offering, he would have treated the option as invalid under state law and would have refused to sell, and that Thompson's failure, in January 1969, when the option was exercised, to disclose its plans for a public offering violated SEC Rule 10b-5.

Parenthetically, the evidence established that Ryan really knew of the possible public offering. For in delivering his stock to Thompson, he not only described the option price of $45.24 a share as "gratifying", but stated that "if and when JWT goes public I surmise this same asset value, plus mark up for the earnings 'intangibles' would command about $125". (A. 15). This prompted the District Court to refer to the issue, which it found unnecessary to decide, that "Ryan had knowledge, when the option was exercised, that Thompson was planning to go public" (A. 23).

I

This Court will not normally review questions of state law determined by intermediate federal appellate courts.

Both courts below applied state law as to the validity of a 90-day first option in a corporation to repurchase its stock, as reflected in *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957). The District Court, describing this case as "the controlling decision in New York" (A.

21), concluded that "Under the New York decisions, therefore, the first option to Thompson was valid whatever may have been the policy of Thompson in January 1969" (A. 22).

The Court of Appeals, also relying on *Allen* as controlling, agreed that under New York law an option "giving the corporation a right of first refusal" is valid (A. 4).

Clearly, this is not one of the "exceptional cases" where this Court will review "the considered determination of questions of state law by the intermediate federal appellate courts." *Huddleston* v. *Dwyer, supra.*

II

The Court of Appeals and District Court correctly applied state law.

(1) *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957), sustained a first option, having marked similarity to the Thompson option, except that in *Allen* the option price was identical with the price at which the stock was originally sold to the stockholder, whereas Ryan bought for $83,686 and sold for $276,200.

In *Allen,* the Court of Appeals stated (p. 541):

> "The question posed, therefore, is whether the provision, according the corporation a right or first option to purchase the stock at the price which it originally received for it, amounts to an unreasonable restraint. In our judgment, it does not.

"The courts have almost uniformly held valid and enforcible the first option provision, in charter or by-law, whereby a shareholder desirous of selling his stock is required to afford the corporation, his fellow stockholders or both an opportunity to buy it before he is free to offer it to outsiders. (See, e.g., *Penthouse Properties* v. *1158 Fifth Ave., supra,* 256 App. Div. 685; *Hassel* v. *Pohle,* 214 App. Div. 654; *Cowles* v. *Cowles Realty Co.,* 201 App. Div. 460; *Palmer* v. *Chamberlin,* 191 F. 2d 532; *Doss* v. *Yingling,* 95 Ind. App. 494; *Baumohl* v. *Goldstein,* 95 N. J. Eq. 597; see, also, 8 Fletcher, *op. cit.,* §4205, p. 787). The courts have often said that this first option provision is 'in the nature of a contract' between the corporation and its stockholders and, as such, binding upon them. (*Hassel* v. *Pohle, supra,* 214 App. Div. 654, 658; see, also 8 Fletcher, *op. cit.* §4194, p. 736.)"

The Court of Appeals further stated (p. 542):

"As the cases thus make clear, what the law condemns is, not a *restriction* on transfer, a provision merely postponing sale during the option period, but an effective *prohibition* against transferability itself. Accordingly, if the by-law under consideration were to be construed as rendering the sale of the stock impossible to anyone except to the corporation at whatever price it wished to pay, we would, of course, strike it down as illegal. But that is not the meaning of the provision before us. The corporation had its option only for a 90-day period." (Italics the court's.)

Here, the District Court, in referring to the Thompson option and applying the *Allen* case, stated (A. 20):

"It must be emphasized that such an option does not prevent a transfer, nor does it condition a transfer on any consent. The option merely delays a trans-

> fer for a period within which the corporation may buy its shares. If the corporation does not buy, there are no restrictions on transfer."

The Court of Appeals, also citing the *Allen* case, stated that "regardless of the corporate policy underlying the option agreement, such agreement would be invalid only if it prevented transfer of the stock, as opposed to merely delaying transfer, as here, by giving the corporation a right of first refusal" (A. 4).

As already noted, *Allen* held that a restriction on transfer would be invalidated only where it rendered sale of the stock "impossible to anyone except to the corporation at whatever price it wished to pay." This is not the case here, where Thompson merely had a 90-day option; where the option price was fixed in the option agreement; and where Ryan obtained a $192,514 profit on an $83,686 investment.

(2) The *Allen* decision, which represents New York law, had previously been followed in both the Second and Seventh Circuits, when they had occasion to consider the validity of such options under New York law.

Thus, *Globe Slicing Machine Co.* v. *Hasner,* 333 F.2d 413, 415 (2d Cir. 1964), states:

> "Under New York law first option provisions restricting alienation of stock through testamentary as well as *inter vivos* transfers are valid. Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534."

In *Martin* v. *Graybar Electric Co.,* 285 F.2d 619 (7th Cir. 1961), which also involved a 100% employee-owned

New York corporation, the plaintiff-employee had bought his stock at $20 a share and had granted the corporation "an option to purchase his stock at $20.00 a share, on cessation of employment" (p. 622). The Seventh Circuit also found the *Allen* case controlling as to validity of a New York corporation's option to purchase its employees' stock on termination of employment (p. 625).

The *Allen* case, which represents the law of New York, was properly applied by both courts below.

(3) The petition fails to point to any contrary state appellate court decision. The only New York case relied on in the petition (pp. 9-10) where an option was not enforced, is *Matter of Sands Point Land* v. *Rossmore*, 43 Misc.2d 368 (Sup. Ct. Nass. Co. 1964). That case, however, did not hold the option invalid, but merely held that an option to buy was not intended to apply to "the *dissolution* of a corporation, as distinguished from a *sale*" (p. 372; italics the court's). But even were this case in conflict with the decision below, failure of a federal intermediate appellate court to follow a decision of a *nisi prius* court at Special Term, which is not even binding on other New York courts, does not warrant grant of certiorari. *King* v. *Order of Travelers*, 333 U.S. 153, 161 (1948)).

(4) Finally, even if a change in Thompson's policy from 100% employee-ownership to 73% employee-ownership could, under New York law, have rendered the option invalid, the change had not been made when Ryan sold his stock in January 1969, but was made months later. A change in policy made June 1969 could not affect validity of an option exercised four months previously. As to this

fact, which alone is a conclusive bar to Ryan's claim, the District Court stated (A. 23):

> "Assuming that such a change in policy would affect the validity of the option, no such change had in fact occurred in January 1969.
>
> "It seems clear that Thompson did not change its policy of 100% ownership by employees until June 4, 1969, when the underwriting agreement was signed. It planned to change its policy, expected to change its policy, took steps to change its policy in and before January 1969 but did not in fact change its policy and could not be sure that it would change its policy until June 4, 1969. The reason, as already noted, was that if for any reason the public offering could not be accomplished, Thompson had to be able to continue its then policy of 100% employee ownership; it would be forced to turn to means for raising working capital other than by sale of stock to the public.
>
> "When the option was exercised in respect of the stock of Ryan, Thompson was 100% employee owned and might so remain indefinitely."

Since the petition is premised on the contention that the court below decided an important state question in a way which is in conflict with applicable state law, whereas in fact the court below clearly followed applicable state law, there can be no basis for granting the writ.

III

The case does not involve an important question of federal law.

The petition also claims that the Court of Appeals decided an important question of federal law which has not been, but should be, settled by this Court; and asks this Court "to clarify the disclosure requirements mandated by Section 10(b) * * * and the SEC Rule 10b-5" (p. 1). As the court below stated at the outset, the petitioner has invoked "the salutary anti-fraud provisions of the federal securities laws" in a case "where those provisions are wholly inappropriate and wide of the Congressional mark" (A. 2). It also described the federal securities law claim as "misplaced", and stated that petitioner was merely asserting "a state law claim that, but for the federal gloss, should have been litigated in the state courts" (A. 2).

Rule 10b-5 does not apply to a sale made under a pre-existing option. The Rule's purpose is to provide "equalization of bargaining position" by enabling outsiders to "exercise an informed judgment". *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 829 (D.Del. 1951), *aff'd*, 235 F.2d 369 (3d Cir. 1956). As stated in *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965), the Rule requires disclosure of information which would have affected a seller's judgment "so as to put the seller in an equal bargaining position with the buyer". However, where the seller has no judgment to exercise and is not in a position to bargain, because already contractually bound under an option to sell, Rule 10b-5 has no application.

Accordingly, the District Court held (A. 22):

> "Ryan was therefore obligated to sell his shares to Thompson in January 1969. Whatever he knew or did not know made no difference in what he was required to do. There can be no possible claim under Section 10(b) and Rule 10b-5 in such circumstances. See *Lawrence* v. *Sudman,* 70 F.Supp. 387, 396 (S.D. N.Y. 1945)."

The Court of Appeals, in considering the Rule 10b-5 claim, agreed that "since Ryan was obligated to sell his shares to JWT in January 1969, whatever he knew or did not know regarding JWT's plans to go public was irrelevant" (A. 4-5).

The issue whether Rule 10b-5 applies to sales by persons already contractually obligated to sell under a valid pre-existing option is not "an important question of federal law."

Conclusion

The petition for a writ of certiorari should be denied.

March 31, 1972

Respectfully submitted,

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